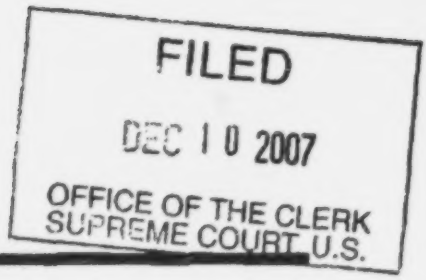
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(4)

No. 07-241

IN THE

Supreme Court of the United States

HOMAN MCFARLING,
Petitioner,

v.

MONSANTO COMPANY,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

REPLY BRIEF FOR THE PETITIONER

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TABLE OF CONTENTS

Page

REPLY BRIEF FOR THE PETITIONER 1

I. Monsanto's windfall in this case remakes the law of patent damages. 2

II. Monsanto exhausted its patent rights with its sale of seeds to McFarling. 8

TABLE OF AUTHORITIES

Page(s)

CASES

B. Braun Med., Inc. v. Abbott Labs., 124 F.3d 1419 (Fed. Cir. 1997) 10

Mallinckrodt, Inc. v. Medipart, Inc., 976 F.2d 700 (Fed. Cir. 1992) 12

Monsanto Co. v. Ralph, 382 F.3d 1374 (Fed. Cir. 2004) 5, 6, 9

Quanta Computer, Inc. v. LG Electronics, Inc., (No. 06-937) 2, 10

United States v. Univis Lens Co, 316 U.S. 241 (1942) 1, 12

STATUTES

35 U.S.C. §154(a) 11

REPLY BRIEF FOR THE PETITIONER

Monsanto bases its opposition to certiorari on two mistakes. First, Monsanto claims that McFarling somehow used Monsanto's seeds in a "broader" way than any other farmer and therefore should be required to pay Monsanto $40 per bag of seeds—even though, but for the infringement, he would have paid Monsanto only $6.50 per bag. Monsanto is wrong. Both the district court and the Federal Circuit noted that McFarling neither sold nor modified the seeds he saved. Rather, he planted a known, limited number of those seeds on his own land, and stopped when ordered to do so. As a result, Monsanto's loss is precisely quantifiable—and is less than one-sixth of what McFarling has been ordered to pay. The Federal Circuit justified this enormous windfall to Monsanto by including in the award two things that have never been part of modern patent-damages law—money that McFarling would have paid to third parties; and the value that McFarling theoretically should have placed on having access to the seeds. In doing so, the Federal Circuit remade the law of patent damages in radical and dangerous ways.

Second, Monsanto claims that McFarling cannot raise a patent-exhaustion defense because the use that he made of the seeds produces new seeds as the planted ones sprout and grow. Monsanto's argument misunderstands the exhaustion doctrine, which, under *United States v. Univis Lens* extends to defendants who buy an unpatented product and then infringe the patent by making the ordinary and cus-

tomary use of that product. The Federal Circuit's decision would permit Monsanto to sell seeds to farmers and then sue them for planting those seeds, regardless what they intended to do with the plants. No reasonable understanding of the exhaustion doctrine would allow Monsanto to reach that far. This Court will rule on the exhaustion doctrine in 2008 in *Quanta v. LG Electronics*. It should not allow this extreme result to slip through the cracks in the meantime.

I. Monsanto's windfall in this case remakes the law of patent damages.

The Federal Circuit held that an infringer is liable to the patent owner not only for the royalties that he agreed to pay the patent owner (the $6.50-per-bag Technology Fee), but also for fees that he agreed to pay to third-party distributors (the Seed Company Fee)—even though the patent owner had no standing to seek those fees, and even though the fees included the distributors' expenses and therefore did not represent ***anyone's*** lost profits. Having thus granted the patent owner—Monsanto—a huge windfall by setting a grossly inflated "floor" of $22.50 to $28.50 a bag under its damages analysis, the Federal Circuit then went even further, upholding a jury award of $40 per bag by ignoring both the established royalty and the established law of damages.

Approving this windfall for patent owners required the Federal Circuit to turn its back on the settled rule that an established royalty precludes the use of a higher "hypothetical" royalty, and to override Congress's 1946 decision to eliminate equitable

disgorgement as a measure of patent damages. These alterations to the fabric of patent-damages law warrant this Court's review.

1. To justify the Federal Circuit's departure from the established royalty, Monsanto theorizes that McFarling was doing something broader and more harmful to Monsanto's rights than simply planting two seasons' worth of seeds that he could have purchased from any Roundup Ready seed distributor at a fixed, established price. This premise allows Monsanto to argue that "no established royalty" existed here, because McFarling would have had to pay Monsanto more than $25.50 to $28.50 per bag to obtain a license to engage in these "broader" activities—whatever they were.

As a threshold matter, this argument gives the Federal Circuit's opinion a major facelift to make it seem less controversial. Contrary to Monsanto's assertions, the Federal Circuit never said that there was "no" established royalty in this case. Had it said that, its resort to a hypothetical royalty might have appeared somewhat less objectionable. Rather, the Federal Circuit said that it would be "improper" to treat the Technology Fee—even when *augmented* by the much larger Seed Company fee—as being the "reasonable royalty." App 12a. Thus, this case squarely presents the issue whether an established royalty may be disregarded in favor of a higher, hypothetical one. Monsanto's insistence that the Federal Circuit found "no" established royalty is an attempt to obscure the full doctrinal import of *McFarling III*.

Monsanto asserts that McFarling "cannot claim the benefit of an established royalty for use of an invention far narrower than the scope of his infringement." MB at 12. But Monsanto never adequately explains why the unauthorized use that McFarling made of the patented invention was any "broader" than what Monsanto routinely allowed farmers to do under license.[1] McFarling planted second-generation seeds for two seasons only on his own land. McFarling did *not* sell or give away seed to other farmers, and therefore did not undercut other sales that Monsanto might have made. Nor did he keep replanting saved seed on his own land in perpetuity. Monsanto obtained an injunction against that conduct, and McFarling complied with it. As a result, we know exactly how many seeds McFarling

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[1] Indeed, that assertion collides head-on with *McFarling III*'s patent-misuse holding. In rejecting McFarling's patent-misuse defense, the Federal Circuit observed that "'the licensed and patented product (the first generation seeds) and the good made by the licensed product (the second-generation seeds) are nearly identical copies.' Thus, 'given that the . . . patent reads on the first-generation seeds, it also reads on the second-generation seeds.'" App. 6a-7a (citation omitted). The Federal Circuit therefore held that there was no patent misuse because "the prohibition against use of second-generation seeds was simply a prohibition against unlicensed use of the patented invention." App. 6a. In other words, the Federal Circuit rejected McFarling's patent-misuse defense based on the premise that there is *no significant difference* between planting a first-generation seed and planting a second-generation seed. Yet Monsanto's "broader use" rationale for ignoring the established royalty turns on *repudiating* that premise by insisting that there *is* something fundamentally different—or "broader"—about planting second-generation seeds. Monsanto can't have it both ways.

replanted, and exactly how much he would have paid Monsanto for those seeds had he purchased them instead of replanting them.

Had McFarling not infringed, he would have purchased seeds from Monsanto for the two seasons in which he replanted them. Monsanto would have made additional profits on the sale of those seeds. But those lost profits are what *every* farmer pays Monsanto—$6.50 per bag, not $40 per bag.

Monsanto's "broader use" rationale for ignoring the established royalty violates the compensatory purpose of the patent-damages statute by permitting the patent owner to recover damages to "compensate" it for money that it would never have earned and that hence represents a pure economic windfall. To accept this argument would be to open a dangerous new loophole that patent owners could use to argue that they should be compensated for losses to third parties and allowed to collect the defendant's profits from a use. That has never been the law.

Monsanto's "broader use" rationale not only fails on its merits, but also bears no relationship to what the Federal Circuit actually said in *McFarling III*. *McFarling III* does not articulate the "broader use" rationale. Unable to point to any "broader use" language in *McFarling III* itself, Monsanto falls back on a different case that is cited in passing in *McFarling III*—namely, *Monsanto Co. v. Ralph*, 382 F.3d 1374 (Fed. Cir. 2004). *See* Opp. 11; App. 11a. But *Ralph* is clearly distinguishable, as the infringing use in that case really *was* "broader" than any use authorized by Monsanto's existing licenses. In *Ralph*, the

defendant sold or gave second-generation Roundup Ready cottonseed to at least three other farmers, creating a situation in which Monsanto soon would have lost control over the patented technology. *See id.* at 1378. He then compounded that misconduct by lying about it and blocking efforts to discover it, making it impossible to determine exactly how much seed he had planted or sold. *See id.* at 1377-82.

This case, by contrast, involves an infringing use practically identical to that for which Monsanto charged an established royalty. Yet the Federal Circuit abandoned the sensible rule that an established royalty precludes a hypothetical one and instead adopted a rule that awards super-compensatory damages. Perhaps this reflects a policy judgment by the Federal Circuit that massive economic deterrence is the only way to protect those who own patents on self-replicating technologies. But Congress has not authorized the courts to award such damages, and neither does this Court's precedent. A policy change of this magnitude deserves careful legislative study, not the back-door adoption of a fundamentally new theory of damages.

2. Monsanto also urges this Court to ignore everything that the Federal Circuit said about the "reasonable royalty" being *no less than* the sum of the Technology Fee and the Seed Company Fee. *See* App. 10a-12a. These words were mere *dicta*, Monsanto asserts, because the court ultimately concluded that there was "no established royalty" for McFarling's unauthorized use of second-generation seeds and so the court must have based its affir-

mance of the damages award *entirely* on the higher, "hypothetical" royalty. Opp. 14.

Monsanto has every reason to want to sweep this part of the Federal Circuit's analysis under the carpet. After all, it was in this part of its opinion that the Federal Circuit indefensibly held that patent damages may include (1) losses sustained by third-party distributors of the patented goods, despite the patent owner's obvious lack of standing (*see* App. 11a-12a), and (2) deterrence-based disgorgement of infringer benefits, despite Congress's elimination of that remedy in 1946. *See* App. 12a (including Seed Company Fee in "reasonable royalty" to prevent "windfall for infringers").[2] But Monsanto's argument for ignoring more than half of the Federal Circuit's damages analysis fails, for two reasons.

First, the "dicta" argument depends on erroneously characterizing the opinion as having held that there was "no established royalty" for McFarling's infringing activity. As explained above, that is not what the opinion says.

Second, the Federal Circuit's extensive discussion on this point was not mere *dicta*, because it set the *floor* for the entire damages analysis. *See* App 12a (stating that it would be "improper" to hold that Monsanto's reasonable royalty damages are "*limited to*" $25.50 to $28.50 per bag) (emphasis added).

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[2] The "disgorgement" rationale also appears, at least implicitly, in the Court's discussion of the "hypothetical" royalty. *See* App. 13a-15a (discussing benefits of technology to infringer).

Even assuming that the discussion in question was mere *dicta*, however, these lengthy and deliberate teachings from the Federal Circuit are likely to influence the conduct of patent trials nationwide. When those teachings are coupled with a holding authorizing lower courts to disregard established royalties in favor of inflated hypothetical ones that grant huge windfalls to patent owners, the case for Supreme Court review is clear.

Accordingly, this Court should grant McFarling's petition for a writ of certiorari on the damages issue.

II. Monsanto exhausted its patent rights with its sale of seeds to McFarling.

1. Monsanto urges this Court to lump the exhaustion issues that McFarling raises here with those raised in his prior petition to this Court. But the issues are quite distinct, because Monsanto no longer contends that McFarling violated any license. Monsanto's claim during the 2004 appeal sounded in contract, but Monsanto now asserts that its naked patent rights permit it to restrict the post-sale use of its patented good. The question is fundamentally different: not whether *contract* law enables a patentee to impose post-sale restrictions on purchasers, but whether *patent* law does.

Under Monsanto's theory, McFarling's liability cannot be premised on his *saving* of seeds, as the patent laws grant no exclusive right of possession. Nor may liability be premised on McFarling's *sale* of seeds, as there is no allegation of sale in this case. Rather, Monsanto's position is that McFarling in-

fringed the patent by *planting* the seeds, since he did so knowing that seeds planted in the ground would grow into mature plants and make new seeds.

Monsanto claims to regard only the planting of *second-generation* seeds as infringing. But Monsanto's legal theory is incapable of drawing a principled distinction between planting first- and second-generation seeds. Under Monsanto's expansive theory, McFarling's act of planting the seeds he purchased from seed companies was not a "use" protected by the exhaustion doctrine, but instead an act of manufacturing falling outside that doctrine's ambit. The only distinction between the first- and second-generation seeds—the fact that Monsanto purported to license only the former for planting—evaporated when Monsanto waived its contract claim. This critical difference separates the issues presented here from those on which this Court previously denied certiorari. And it means that to sustain the Federal Circuit's decision, Monsanto must defend an interpretation of the exhaustion doctrine so cramped as to render that doctrine a nullity.

2. Nor is the patent-exhaustion issue waived. As Monsanto recognizes, "[a]lthough the question of patent misuse is doctrinally distinct from that of patent exhaustion, on the facts of this case they are closely related." Opp. at 18. Each question, in this case, centers on "essentially the same argument: that Monsanto surrenders any legitimate patent rights it has in second-generation soybean seed when the first generation of seed is sold." *Id.* And because under Federal Circuit law a patent cannot be misused unless the patentee attempts to extend

the patent beyond its lawful scope, *B. Braun Med., Inc. v. Abbott Labs.*, 124 F.3d 1419, 1426-27 (Fed. Cir. 1997), resolution of the patent-misuse issue necessarily requires resolving the exhaustion question, which determines whether Monsanto is seeking rights beyond what patent law provides.

In the decision below, the Federal Circuit explicitly recognized the continuing vitality of McFarling's misuse argument, embarking on a new patent misuse analysis under the '605 patent, where it had previously analyzed the issue only with regard to the '435 patent. App. 7a. It ruled that "[t]here is no patent misuse in the license terms for either patent." *Id.* While the decision below did not equate misuse with exhaustion in so many words, the briefing below did, and on the facts of this case, as Monsanto recognizes, they form "essentially the same argument."

Monsanto cannot credibly claim to be surprised by McFarling's exhaustion argument; indeed, from the outset of this case, one central argument has been that Monsanto's patent monopoly was exhausted at the moment that ownership of the seeds passed to McFarling. The exhaustion issue is properly presented.

3. On September 25, 2007, this Court granted certiorari in *Quanta Computer, Inc. v. LG Electronics, Inc.* (No. 06-937). For three reasons, this case is a logical companion to *Quanta*.

First, the cases present striking parallels. In each case, a patented invention purchased from a

licensee was put to its only reasonable use. The Intel computer components in *Quanta* were combined with non-Intel components, since the only other function those components could have served was to take up space. Likewise, the seeds in this case were planted in the ground, the natural use that farmers make of those seeds. Monsanto claims that *Quanta* presents is different because soybeans can be sold as a commodity, rather than being put to their only reasonable use in farming. Opp. 19. But this distinction fails: computer components, like soybeans, can be bought and sold on the open market. This does not change the fact that the only reasonable use of the computer components in *Quanta* was their combination with non-Intel computer components, or the fact that the only reasonable use of the seeds in this case is planting them in the ground. No farmer buys 50-pound quantities of soybean seeds to eat at home.

Second, the differences that do exist between the two cases would allow the Court a comprehensive view of the patent-exhaustion issue. Unlike computer components, seeds replicate themselves when put to their only reasonable use. For this reason, there can be no reasonable "us[e]" of the seeds without "making" new seeds. 35 U.S.C. §154(a). This Court should review this case in the same term as *Quanta* because only by considering both types of cases can it get a complete picture of the circumstances in which exhaustion arises.

Third, the law of patent exhaustion in the lower courts has developed along radical lines since this Court's most recent opportunity to speak on the

issue in *United States v. Univis Lens Co*, 316 U.S. 241 (1942). In the line of cases represented by *Mallinckrodt, Inc. v. Medipart, Inc.*, 976 F.2d 700 (Fed. Cir. 1992), the Federal Circuit has unmoored post-sale restrictions on patented goods from their legitimate basis in contract law and instead has allowed unilateral post-sale restrictions to be enforced through patent remedies. Because the decision below is the product of this straying, almost any result that this Court reaches in *Quanta* is likely to affect the legal standard applied below in this case. Indeed, in the very same week in which Monsanto filed its brief arguing that *Quanta* would *not* affect the outcome of this case, the Biotechnology Industry Organization ("BIO")—of which Monsanto is among the largest members—argued in its brief in the *Quanta* case that this Court needed to draw a careful line in *Quanta* because of the effect that the exhaustion decision there could have on seed-saving cases like *McFarling*. Brief of the BIO as *Amicus Curiae* in Support of Neither Party, *Quanta* (No. 06-937). Given BIO's acknowledgment that the cases are conceptually linked, the Court should at least hold this case until the same issues are resolved in *Quanta*.

Accordingly, the Court should grant McFarling's petition for certiorari on the patent-exhaustion issue.

Respectfully submitted,

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